As stocks stumble, fixed annuities are suddenly hotter

Cash for Certain

BY JOHN GREENWALD

COULD YOU OUTLIVE YOUR money? Millions of American workers who are heading for the exit door of their careers may face that risk as companies phase out their costly check-a-month pension plans and the stock market continues to put serious cracks in people's 401(k) nest eggs.

Such concerns have begun to focus more attention on an obscure insurance product called an immediate fixed annuity. And the attention is more flattering than in the past. Scorned for their modest returns while the bull market roared, these annuities are suddenly gaining some respect for the security they offer. The deal: for a lump-sum premium, you get a guaranteed monthly income that starts immediately and continues for as long as you live—just like a pension. "This is an extremely important function that is not obtainable under any other strategy," says Mark Warshawsky, director of research for TIAA-CREF, the largest U.S. educational retirement fund. "There is a useful place for this in people's portfolios."

Sales of immediate fixed annuities rose 37%—to $3.3 billion—in 2000, according to Limera International, an industry trade group. That was just a warm-up for this year's first quarter, when sales surged 64%. "This has been a very, very hot topic as the number of retirees increases," says Eric Sondergeld, a Limera vice president. Farrell Dolan, a senior vice president for the life-insurance arm of Fidelity Investments, notes that the retirees will soon include droves of baby boomers. He says, "This market will only get bigger."

Sales of immediate fixed annuities are still dwarfed by those of deferred variable annuities, which consumers can buy in installments and which have payouts pegged to the performance of mutual funds. Americans ponied up $137 billion for variable annuities in 2000, compared with $122 billion in 1999. But the grizzly stock market is beginning to bite. Sales of variable annuities fell 21% in the first quarter of this year, the first decline in 22 quarters.

All annuities are insurance products that pool people's premiums and pay out principal and interest plus some of the cash of those who have died. This allows long-lived individuals to receive far more income than they paid in.

Immediate annuities can provide substantially more current income than securities like government bonds. These days, a $100,000 joint-and-survivor-annuity premium generates about $7,300 in annual income, compared with $5,400 for a $100,000, 30-year U.S. Treasury bond. Note, however, that with a bond, you get your $100,000 back; an annuity uses up the principal. Annuity income can vary widely, so it pays to get quotes from insurers and scan websites like *WebAnnuities.com*. An insurer's financial strength also matters; check the ratings from services such as Moody's or A.M. Best.

One big risk in annuities is actuarial. If you die within a few years of purchasing an immediate fixed annuity, you will merely have financed someone else's retirement—a fact that can scare off customers. "People tend to worry about being losers," says Craig Copeland, a senior researcher at the Employee Benefit Research Institute. "And they don't want to run that risk." Inflation is another hazard: a modest 3% rate can cut the purchasing power of fixed-annuity payments 45% in 20 years.

Both of these dangers, however, can be offset to a certain extent. Annuities can include survivor benefits, for example, and some annuities pay income pegged to inflation-indexed Treasury securities. In any case, experts advise retirees to put no more than one-third of their retirement money into annuities. The rest can be divided among growth vehicles, such as stocks and bonds, and liquid assets like money-market funds that can be drawn upon in emergencies.

Such strategies may spread swiftly as companies jettison the pensions that generations of Americans once worked for. As recently as 1992, traditional pension funds held 21% more assets than 401(k) accounts, IRAS and other defined contribution plans. Today these newer plans hold 15% more than pension funds, and the margin is expected to widen. With a growing number of retirees thus left to the tender mercies of financial markets, many are likely to turn to immediate fixed annuities as a haven they can count on. ■

Illustration for TIME by Cathie Bleck